

GAO

Report to the Honorable
Richard H. Baker, House of
Representatives

December 1989

AID-FINANCED PROCUREMENT

Allegations of Irregularities in the Procurement of an Oil Drilling Chemical



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**National Security and
International Affairs Division**

B-233223

December 15, 1989

The Honorable Richard H. Baker
House of Representatives

Dear Mr. Baker:

This report responds to your request that we review the quality of a product involved in two contracts awarded to Messina, Inc., by the governments of Jordan and Pakistan. These contracts for sodium carboxymethyl cellulose (CMC) were financed by the Agency for International Development's (AID) commodity import program. Specifically, you asked us to examine into allegations made by a manufacturer of this product—Louisiana Chemical Polymers, Inc. (LCPi)—that the product supplied by Messina failed to meet contract specifications and AID's "source and origin" regulations. These regulations require that products financed by AID's commodity import program be shipped from a U.S. port and that at least 50 percent of the cost of the product's components originate in the United States. A complete description of our objectives, scope, and methodology is in appendix I.

Background

In 1987, the governments of Jordan and Pakistan issued invitations for bids (IFBs) on two competitive, fixed price contracts for 150 metric tons and 200 metric tons, respectively, of low-viscosity CMC, a semisynthetic, water soluble polymer used for oil drilling. The IFBs stated that the product must conform with or exceed the specifications established by the Oil Companies Materials Association for low-viscosity CMC. The Pakistani IFB also listed four additional physical properties that should be present in the product. Jordan did not establish any additional requirements.

Both the governments of Jordan and Pakistan awarded both contracts to Messina, Inc., an international petroleum service company. The Jordanian contract was awarded on October 21, 1987, for \$200,203, and the Pakistani contract was awarded on January 10, 1988, for \$268,256.

Shortly after the Jordanian contract was awarded, LCPi alleged that the Jordanian award and Messina's bid on the Pakistani IFB did not meet specifications. LCPi alleged that the CELTROL-LV, a trade name for a drilling product manufactured by Messina, supplied to Jordan did not meet the Association's specifications for low-viscosity CMC and that the

CELTRON-LV being sold to both governments came from a foreign manufacturer in violation of AID's product origin requirements.

Results in Brief

The CELTRON-LV shipped by Messina to the governments of Jordan and Pakistan under the two contracts we examined met the Association's specifications for low-viscosity CMC. Laboratory tests conducted by the government of Jordan showed that the CELTRON-LV provided to Jordan met the Association's specifications as required by that government's IFB. Laboratory tests performed for us by an independent testing laboratory showed that the CELTRON-LV provided to Pakistan also met the Association's specifications, but it met only two of the four additional physical property specifications required by the Pakistani government's IFB. The products provided to both governments by Messina met AID's source and origin requirements.

Although the allegations of noncompliance with Association specifications and with AID source and origin requirements proved to be generally incorrect, we noted that AID does not have written procedures for investigating allegations of noncompliance with technical specifications or source and origin requirements. AID's policy in such cases is to inform the host country of the allegations and to rely on the host country to investigate the matters.

CELTRON-LV Met Jordanian Bid Requirements

Shortly after the government of Jordan awarded its contract to Messina, LCPi alleged to the government of Jordan that the CELTRON-LV offered by Messina was purchased from a foreign producer. LCPi also alleged to AID that CELTRON-LV did not meet the Association's requirements for low-viscosity CMC, as stipulated in the Jordanian IFB. LCPi stated to the AID missions in Jordan and Pakistan that CELTRON-LV was a blend of mostly starch and salt and that this could cause catastrophic failure during the drilling process.

In response to these allegations, the government of Jordan tested the product received from Messina and found that it met the Association's specifications listed in its IFB. We did not have the product retested; however, we reviewed the procurement documents for the product provided to Jordan and found that the product met AID's source and origin requirements.

CELTRON-LV Did Not Meet All Pakistani Bid Requirements

Before Pakistan awarded its contract to Messina, LCPI, contending to be the sole U.S. manufacturer of low-viscosity CMC, notified AID that Messina had not purchased CMC from it and, therefore, the product offered in Messina's bid must contain foreign-made CMC. In response to this allegation, Messina assured AID that its product conformed with Pakistan's IFB requirements for a U.S.-origin product and, if awarded the contract, would welcome an inspection of its product and manufacturing plant. Based on these assurances, the government of Pakistan awarded the contract to Messina.

After the Pakistani contract was awarded, LCPI again alleged to AID that since Messina had not purchased the CMC from it, the product being provided to the governments of Jordan and Pakistan was not CMC, but instead a blended compound of mostly starch and salt. AID accepted Messina's offer to have the product tested before shipment to Pakistan. The Societe Generale de Surveillance (SGS), an international commercial testing company, was employed by Messina to determine if CELTRON-LV met the Pakistani IFB specifications. If the product did not meet all the specifications listed in the Pakistani IFB, AID was prepared to prevent Messina from shipping CELTRON-LV to Pakistan.

SGS selected samples from 10 product lots for testing. Messina tested the product for compliance with the Association's specifications for low-viscosity CMC while SGS witnessed the tests. The tests, however, did not include testing for compliance with the four additional physical properties required by the government of Pakistan. While SGS maintained custody of the samples until the tests were performed at Messina's laboratory in Dallas, it did not perform the tests, it only witnessed them. According to an SGS official, this is a common practice.

At the completion of the tests, SGS issued a "Certificate of Sampling and Verification of Analysis," which certified that it had witnessed the tests performed by Messina and that CELTRON-LV complied with the Association's specifications for low-viscosity CMC. SGS did not certify that the product tested met all IFB specifications. SGS (1) had no input into the selection of tests to be performed by Messina, (2) was not informed of the contract specifications or additional physical properties required by the government of Pakistan, and (3) did not independently verify that the product was CMC.

According to an AID official, AID misinterpreted SGS's certificate and Messina's transmittal memorandum and incorrectly assumed that SGS had independently performed the tests and the tests indicated compliance

with all IFB specifications, not merely compliance with Association standards for low-viscosity CMC. AID incorrectly concluded that Messina's shipment of CELTROL-LV complied with all of the Pakistani IFB specifications. The Pakistani shipment of CELTROL-LV departed from Houston on August 2, 1988.

AID was subsequently advised that the tests witnessed by SGS were actually conducted by Messina and that they did not address all specifications cited in the Pakistani IFB. AID advised the government of Pakistan of this; but, by this time, the product had already been delivered. The government of Pakistan informed AID it was not concerned that the CELTROL-LV was not tested for the four additional specifications because these additional specifications were "of minimal importance" and "insignificant." However, AID rules applicable to competitive bid situations involving a contract between a foreign government and a U.S. supplier under the commodity import program require a commodity to conform to the description contained in the contract with the purchaser.¹ An AID procurement official stated, and we agree, that it is not permissible to evade this requirement by stating that a requirement not met is unimportant.

To determine whether the shipment met Pakistan's IFB requirements, we obtained a sample of the CELTROL-LV from AID officials in Pakistan and had it analyzed by a commercial testing laboratory. The analysis showed that the product met Association specifications for low-viscosity CMC but did not meet two of the four additional physical properties required by the Pakistani IFB. Specifically, the pH content (a measure of the acidity) of the CELTROL-LV was lower than the values specified in Pakistan's IFB and had a degree of substitution factor (a measure of the amount of CMC present in a product) of only 0.1, although the Pakistani IFB and contract called for CMC with a substitution factor of between 0.8 and 0.9. This analysis also confirmed LCPI's charge that the product was primarily starch.

Industry and American Petroleum Institute officials we interviewed stated that the pH level requested in the Pakistani IFB was not necessary for selecting an appropriate CMC product for oil drilling; that is, the pH content of a product is insignificant in determining its quality. However,

¹22 C.F.R. 201.31(b); Messina's contract with Pakistan incorporated by reference the IFB's technical specifications. See also 22 C.F.R. 201.22(d) requiring that awards be based on bids "conforming" to the IFB.

industry representatives told us that the degree of substitution specification is important in cases where questions are raised about the quality of the product.² The higher the degree of substitution, the higher the amount of CMC and the lower the amount of impurities present in the compound. The lower the CMC content, the greater the probability that the product is susceptible to decomposition at deep drilling levels because of the heat generated. According to a representative of the American Petroleum Institute, this could result in catastrophic failure in the drilling process.

A representative of a major oil company stated that the company makes it a practice to purchase CMC with the lowest concentration of impurities possible, but does not test the product unless questions arise because it normally purchases such a product in relatively small quantities. The representative added that the company would have tested the product if it had purchased a large quantity like the Pakistani government's purchase of 200 metric tons.

According to AID officials, purchasing governments have the responsibility for preventing commodities that do not meet IFB specifications from being shipped. The officials stated that AID's role is to make the purchaser aware of any allegations of noncompliance and to assure that the purchaser's actions in response to the allegations are appropriate.

AID's Determination of Compliance With Source and Origin Requirements

To ensure that suppliers comply with source and origin requirements, suppliers of a commodity are to submit an Application for Approval of Commodity Eligibility (AID Form 11) and a Supplier's Certificate and Agreement with the Agency for International Development (AID Form 282). AID does not have written instructions for reviewing the accuracy and validity of these certifications. AID officials stated that the procedure is normally limited to ensuring that suppliers complete and sign the certifications before a commodity is shipped. The officials said that the procedures are passed on orally from individual to individual and are learned through experience. An AID official informed us that the source and origin requirement is defined but that AID is not required to routinely validate the supplier's certifications.

²We were unable to find a written, standard, agreed upon definition of technical grade CMC. However, we contacted manufacturers of CMC, academicians, and experts in the oil-drilling industry who identified requirements that a product should have to qualify as a technical grade CMC. These officials, as well as reference material we reviewed, consider a product that contains between 55 percent and 96 percent pure CMC to be a technical grade CMC.

AID's review of the certifications of source and origin may involve three steps: (1) reviewing the supplier's certificate of source and origin submitted with the sale for completeness, (2) contacting the supplier, if necessary, to verify the information on the certificate, and (3) reviewing the supplier's procurement invoices to determine the origin of the purchase. According to an AID procurement official, most reviews of certifications received from well-established suppliers end after the first step. When a new supplier or product is involved, more detailed verification efforts may be undertaken.

AID's initial review of the source and origin certifications for the CELTROL-LV shipment to Jordan was limited to ensuring that Messina completed and signed the appropriate certifications. AID accepted Messina's word that the procurement invoices indicated compliance with AID's source and origin requirements. However, in response to LCPi's allegations concerning the origin of the Messina product, AID subsequently withheld its approval of the pending Pakistani contract and final approval of the Jordanian certification until a more thorough review of the origin of the product supplied through the Jordanian contract could be conducted. AID requested procurement invoices showing the origin of components used in the production of the CELTROL-LV provided to Jordan and the composition of that shipment. Messina stated that the production of CELTROL-LV was a trade secret and refused to provide AID with copies of procurement invoices. However, a Messina representative showed AID procurement officials commercial invoices for various chemicals that, according to the representative, were used to produce the CELTROL-LV sold to Jordan.

The Messina representative did not allow AID to retain copies of the invoices or to take notes during the review. AID officials considered Messina's secretive attitude toward this review to be highly unusual but nonetheless accepted the Messina representative's assertions. AID officials present during this review were not trained in chemistry, and they told us that they could not evaluate Messina's statements that the chemicals cited in the invoices were used to produce the CELTROL-LV or, if they were used, in what quantities. Based on AID's review of the commercial invoices shown by the Messina representative indicating that the components of the CELTROL-LV provided to Jordan were of U.S. origin, AID approved the Jordanian certification.

AID did not review procurement invoices for the CELTROL-LV sold to Pakistan, even though allegations were made that the CELTROL-LV being provided contained foreign-made CMC. Messina was awarded the

Pakistani contract based on the review of the procurement invoices for the Jordanian shipment. In approving the Pakistani contract, AID assumed that the components used to produce the Pakistani CELTROL-LV were also of U.S. origin.

At our request, AID obtained invoices supporting Messina's source and origin certifications for both shipments of CELTROL-LV. Our review of these documents and discussion with the manufacturers of the U.S.-produced components used in Messina's production of the Pakistani CELTROL-LV showed that the CMC component used to manufacture the CELTROL-LV was of Italian origin but that the dollar value of the Italian component was less than half of total manufacturing costs. More than half of the total manufacturing cost was from U.S.-origin components, as verified by the supplier of the non-CMC component. Therefore, the final product complied with established AID regulations for U.S. origin. Since both shipments were dispatched from Houston, both CELTROL-LV contracts complied with AID's source requirements.

Conclusions

The CELTROL-LV provided by Messina to the governments of Jordan and Pakistan under the fixed price contracts met AID's requirements for source and origin, and the shipment to Jordan appears to have met the specification of the IFB. Testing conducted for us by an independent testing laboratory showed that the CELTROL-LV shipped to Pakistan met the Oil Companies Materials Association specifications for low-viscosity CMC but did not meet two of the specifications required in the contract. AID rules applicable to competitive bid situations state that a commodity must conform to the description contained in the contract with the purchaser. An AID procurement official indicated, and we agree, that one possible remedy for noncompliance could be partial recovery of the amount paid.

Recommendation

Because Messina has already delivered the CELTROL-LV to the government of Pakistan under the contract and the product is in use, we recommend that the AID Administrator direct the AID Mission Director in Pakistan to consider during contract close-out that two contract specifications were not met and to determine whether AID should seek an adjustment from the supplier for providing a product that did not meet specifications.

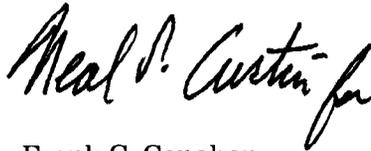
Agency Comments and Our Evaluation

AID agreed with our findings related to these specific cases and agreed with our recommendation to consider these issues during the Pakistani contract close-out process. However, AID said that this was not evidence of systemic problems or deficiencies. The scope of our review was too narrow to determine with certainty that the management concerns identified are systematic. A copy of AID's comments and our response are in appendix II.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to interested parties and make copies available to others upon request.

This report was prepared under the direction of Harold J. Johnson, Director, Foreign Economic Assistance Issues. He can be reached on (202) 275-5790, if you or your staff have any questions. Other major contributors are listed in appendix III.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

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Abbreviations

AID	Agency for International Development
CMC	Carboxymethyl cellulose
GAO	General Accounting Office
IFB	Invitation for Bid
LCPI	Louisiana Chemical Polymers, Inc.
SGS	Societe Generale de Surveillance

Objectives, Scope, and Methodology

Our review included research on the production and uses of CMC, specifications established by Oil Companies Materials Association, and standards identified by the oil-drilling industry. We analyzed statistics on annual CMC production and import/export levels. We met with AID's procurement officials and obtained information on its commodity import program. We also reviewed AID's regulations on its source and origin requirements.

We obtained and reviewed pertinent documents, such as the IFBS, contracts, certifications, supporting procurement vouchers, and correspondence among the parties involved from the time the Jordanian and Pakistani IFBS were issued until the present. We spoke with Messina and LCPi officials to obtain their views on the events. We met with AID procurement officials and reviewed AID's regulations to gain an understanding of the agency's review process for compliance with requirements for purchases under its commodity import program. We met with officials from SGS. We obtained a sample of the CELTROL-LV provided to Pakistan from AID and had it analyzed by an independent testing laboratory to determine compliance with oil industry standards and contract requirements. We used the following criteria for choosing an appropriate testing laboratory: (1) it should be recognized by the American Petroleum Institute, (2) it should not have been identified by LCPi as a potential testing laboratory, and (3) it should be able to conduct all of the required tests. We also spoke with oil industry officials to determine the implications of noncompliance with IFB requirements. We conducted our review in Washington, D.C., during October 1988 to July 1989 in accordance with generally accepted government auditing standards.

Comments From the Agency for International Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON, D.C. 20523



ASSISTANT TO THE ADMINISTRATOR
FOR MANAGEMENT

SEP 27 1989

Frank C. Conanan
Assistant Comptroller General
National Security and International Affairs Division
General Accounting Office
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Washington, D.C. 20548

Dear Mr. Conahan:

This provides comments on the General Accounting Office (GAO) draft report, "A.I.D. Contracting: Irregularities in the Procurement of Oil-Drilling Chemical."

The Agency for International Development (A.I.D.) concurs with the basic findings of the report as follows:

- A. Both shipments met A.I.D.'s source and origin requirements;
- B. The shipment to Jordan met all the technical requirements;
- C. The shipment to Pakistan did not meet two of the technical requirements.

In arriving at these findings, however, A.I.D. considers that the draft report does not accurately reflect the procedures used to implement and maintain the Commodity Import Program (CIP). Therefore, A.I.D. would like to make the following comments on the two primary areas of inquiry.

Source and Origin: The report criticizes A.I.D.'s source and origin review procedures. It asserts that "A.I.D.'s general policy is to take the word of the contractor" and that our source origin reviews "do not follow established procedures and are normally limited to ensuring that the supplier properly completes and signs the appropriate certifications." These assertions are incorrect. A.I.D. has well established policies and procedures to assure that our requirements are met. A.I.D.'s verification efforts in a given case may include discussions with suppliers and producers, review of acquisition

See comment 1.

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invoices, market research and extraordinary measures such as site visits by A.I.D. or other U.S Government agencies where required. We believe our procedures serve us well. We do not have any significant source/origin compliance problems.

See comment 2.

The GAO's description of the specific steps taken to review source and origin for the Jordan shipment omits several important actions taken by A.I.D. during its review to ensure that the source and origin requirements were met. A.I.D. believes that the review was appropriate and was conducted in a prudent and effective manner. Our conclusions, as the GAO findings show, were correct.

See comment 3.

Compliance with Technical Specifications: The report criticizes A.I.D. for not having established procedures for verifying allegations of technical non-compliance on CIP transactions. A.I.D. does have such procedures. The procedures are designed to serve the unique nature of the CIP and must be viewed in the context of that program. As such, A.I.D. would like to comment on the nature of that program.

See comment 4.

A.I.D. itself does not procure goods under CIPs, it merely acts as a financier or bank. The GAO report does not appear to reflect this difference in role. The title of the report "A.I.D. Contracting: Irregularities in the Procurement of Oil Drilling Chemicals" implies a direct, U.S. Government acquisition. That is incorrect. A more appropriate title would be "A.I.D. Commodity Import Program: Allegations of Irregularities in the Procurement of Oil Drilling Chemicals by Host Country Purchasers." Similarly, other terminology used in the report, such as "contractor" for supplier and "voucher" for commercial invoice are more appropriate to a U.S. Government acquisition.

See comment 5.

The distinction between a U.S. Government purchase and a purchase by a host country importer is crucial to understanding A.I.D.'s role in these matters. The major responsibility for assuring compliance with the technical requirements of a solicitation falls upon the purchaser. A.I.D.'s role is to assure that the purchaser is aware of allegations of non-compliance and that the purchaser's actions in response to the allegations are appropriate and complete. CIP purchasers are normally very responsive to such allegations. They have paid for the commodity in local currency and must use it. Accordingly, it is in their interest to assure that what they receive meets their requirements.

Appendix II
Comments From the Agency for
International Development

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The other key aspect of our procedures for dealing with allegations of technical non-compliance is the provision of conditional, limited approval of transactions subject to detailed post-audit following payment and with the reservation of refund rights. A.I.D. conditionally approves commodity purchases based on the "Commodity Approval Application", known as the "Form 11". Approval of the Form 11 by A.I.D. assures the supplier that he may ship pursuant to his purchase contract with a foreign importer and expect payment upon submission of conforming documents. Subsequent to payment, A.I.D.'s Monitoring Branch performs thorough post-audits of all aspects of a transaction. Based on the post-audit, A.I.D. may -- and often does -- assert a refund claim against a supplier for breach of a contract requirement or of any certification made to A.I.D.

A.I.D.'s procedures for dealing with questions of technical non-compliance on CIP transactions are well established and have generally served us well. As with source and origin, we have no significant systemic problem with technical compliance.

In addition to the foregoing general comments on A.I.D. policies and procedures, we have the following specific comment:

On page 8, the GAO asserts that the product supplied to Pakistan by Messina "may become unduly susceptible to biodegradation at deep drilling levels because it cannot withstand the heat generated at those levels." The GAO further states that this could cause a "catastrophic failure in the drilling process." Page 4 of the report includes a similar assertion by the complaining firm regarding the product supplied to Jordan. The product is not intended for deep or "critical" drilling. It is intended for routine drilling operations. The report should note that the product appears to be serviceable for the intended use in that neither purchaser has complained about its performance. Moreover, the Jordanian purchaser has stated that the product performs well "even under extreme working conditions".

We appreciate the opportunity to comment on the draft report. In summary, A.I.D. agrees with the GAO's major findings but does not feel there is evidence of systemic problems or deficiencies.

GAO Recommendation: A.I.D. accepts GAO's single recommendation that the report's findings be taken into consideration during

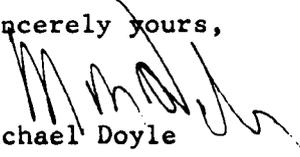
See comment 6.

**Appendix II
Comments From the Agency for
International Development**

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"contract close-out". There will be no need for the Administrator to direct this action personally. It will be accomplished through our USAID Mission in Islamabad. In addition, A.I.D. will retain copies of the report for reference in regard to future purchases of drilling chemicals.

Sincerely yours,


Michael Doyle

GAO Comments

1. The draft report described the implementation of AID procedures in a particular case and not overall AID policies. However, despite AID's statement that it has well-established policies and procedures to assure that requirements are met, we found that these procedures are not written in any AID manual, handbook, or operational guideline. We modified the report to reflect this more accurate and complete characterization. We cannot comment on how well these unwritten procedures have served AID in its other operations, but in our opinion they did not serve AID well in this particular instance. While our review showed that source and origin requirements were met, that determination required examination of contractor documents, which AID had not previously obtained.
2. Our subsequent follow up with AID to determine whether we had left out important aspects of this review did not reveal the omission of any substantive actions. We believe the general descriptions contained in the draft and final report are accurate.
3. AID's written procedures simply state that commodities provided by a supplier in a competitive bid situation must conform to the description contained in the contract and IFB. The procedures for assuring compliance with these requirements are unwritten, nonstructured, and learned through experience. When it receives allegations of noncompliance, AID views its role as ensuring that the purchasing country is aware of the allegations and that appropriate action is taken by the purchaser.
4. We agree with AID and have modified the report title.
5. We agree with AID's observation and have changed the terminology in the report where appropriate.
6. Technical grade CMC, according to industry officials we contacted, is between 55 percent and 96 percent pure CMC. This composition is important to the drilling of deep wells. Lesser grade CMC, even starch, could possibly be sufficient if shallow drilling operations are contemplated. However, the IFBs for Pakistan and Jordan specified technical grade, low-viscosity CMC.

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